Two crises and the fall of communism

Das Kapital prophesied the real cause of the 2007-08 crisis, but communism itself had lost steam a decade and a half earlier — before the 1997 crisis — with the disintegration of the Soviet Union

THE OTHER SIDE

A V RAJWADE

The year 2017 marks the 10th and 20th anniversaries respectively of two major crises in the global economy, whose repercussions continue to be felt even now. Chronologically the first was the balance of payments crisis in several countries in East Asia, and the second was the banking crisis mainly in the US and the UK. Turning to the second first, one of its fallouts was a sharp fall in interest rates. In the advanced economies, interest rates are still at historic lows (though likely to go up shortly) and output is just catching up to pre-crisis levels. *The Economist*, in a special report (May 6) attributed the root cause of the crisis to "a surfeit of savings in China and other surplus economies... financing an American borrowing and property binge. American and European banks, economies and taxpayers bore the brunt". In other words, the guilty party was the Chinese saver, and the helpless American banks were the victims. Strange logic!

The real cause was perhaps far better prophesied by Karl Marx in his *Das Kapital*: "Owners of capital will stimulate the working class to buy more and more of expensive goods, houses and mechanical products, pushing them to take more and more expensive credits, until their debt becomes unbearable. The unpaid debt will lead to bankruptcy of banks, which will have to be nationalised, and the state will have to take the road, which will eventually lead to communism".

The first part of Marx's prophecy is surely relevant to the 2007 crisis. As a neoliberal economic ideology was adopted by policymakers from the 1980s in the Thatcher-Reagan era, wages remained stagnant and income inequality grew. Even today, these are the two countries with the highest income inequalities amongst the advanced economies, as measured by the Gini coefficient. It was politically desirable to give the worse off an illusion of increasing consumption. One way was a strong dollar and imports of cheap Chinese and other goods — financed by the consumer getting larger and larger loans against houses, facilitated by increasing house prices. The loans were securitised and sold in the market in ever more complex structured securities. So long as the going was good, a chain of intermediaries from brokers to valuers to lenders to structurers were feeding themselves on the gravy train — at the cost of the poor homeowner.

The house of cards collapsed when real estate prices started falling; some banks in the UK had to be nationalised and US banks needed huge public support. So far, Marx's prophecy had come true; few economists have that privilege. As for the last part, however, he was wrong. In fact, the music had stopped playing for communism a decade and a half earlier with the implosion and disintegration of the Soviet Union. Boris Yeltsin, the first Russian President, had created a coterie of billionaire oligarchs by selling them state-owned assets cheap. This apart, the "revolt of the proletariat" seems to have taken a different form in the US — electing a billionaire president with a strange ideology and set of advisors, and an economic policy agenda of tax cuts for the rich and reduced health care for the poor, which might well increase income inequalities further. To me, he seems comparable to Yeltsin also in his erratic emotional make-up: He seems to like his tweets and tweet-size attention span as much as the latter liked his drink!

The other major fallout of the crisis of 2007-08 was the tightening of capital adequacy norms for the global banking system. In the US, this was embodied in the Dodd-Frank Act, one of the most complex legislations, and the thousands of pages of regulations framed thereunder. The "small print" in the framework was significantly influenced by lobbyists working for banks, and it is debatable how effective it is — and Donald Trump wants to liberalise the provisions further.

The crisis would have been "wasted" if finance remains the master of the real economy and income inequalities keep growing. For the Anglo-Saxons, who have dominated the world for three centuries, one unintended consequence could be the growing acceptance in the rest of the world of West European social democracy. Some straws in the wind:

■ In Manchester, where he lived and worked for a long time, a statue of Friedrich Engels, Marx's collaborator, was erected last Sunday;

■ The surprising strength of the Labour Party in the recent UK election;

■ The equally surprising bestseller status achieved by Thomas Piketty's *Capital in the Twenty-First Century*, a critique of income inequality.

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CHINESE WHISPERS

Arun Jaitley (*left*) and Sitaram Yechury

Jaitley's 'farewell speech' for his friend Yechury

Finance Minister Arun Jaitley and Communist Party of India (Marxist) chief Sitaram Yechury go a long way back. Both are 1952 born and were contemporaries at Delhi University. Both did their graduation in Economics, Jaitley from Sri Ram College of Commerce and Yechury from St. Stephen's College. The two also went on to become well-known student leaders during and after Emergency years. The two have known each other for more than 40 years, but also get along well and consider each other good friends. This monsoon session is likely to be Yechury's last as a Rajya Sabha member. Jaitley has been telling his close circle of friends that his farewell speech for his friend Yechury would include how he entered the Upper House as a Communist, who went on to lead the CPI (M), but is now exiting when he is also the leader of Congress, given that the top Congress leadership frequently turns to him for advice and that he is more comfortable with the Gandhis than some of the leaders within his own party.

Madhya Pradesh legislators spar

It was Madhya Pradesh all the way in the Lok Sabha on Wednesday when the agrarian situation in the country was being discussed. Lok Sabha Speaker Sumitra Mahajan castigated Congress leader Jyotiraditya Scindia for repeatedly interrupting Rural Development Minister Narendra Singh Tomar while he was making his submission on the issue. Mahajan is a long-time member of Parliament (MP) from Indore, while Tomar has been a legislator from Gwalior. Scindia is an MP from Guna, also in the state. The trigger for the discussion was the police firing on farmers in Mandsaur district.

RSS-backed news service on AIR

Minister of State for Information and Broadcasting (I&B) Rajyavardhan Rathore on Wednesday told the Lok Sabha that the news division of All India Radio has started a "free trial service of *Hindustan Samachar*". On July 12, former I&B minister Manish Tewari had tweeted that Prasar Bharati, the body that runs AIR and Doordarshan, has been instructed to terminate the services of news agencies Press Trust of India (PTI) and United News of India (UNI) and replace them with Rashtriya Swayamsevak Sangh (RSS)-backed *Hindustan Samachar*. Rathore, replying to a written question, denied any plans to stop PTI and UNI news services to AIR, but admitted that it has hired the services of *Hindustan Samachar*. *Hindustan Samachar* was founded in 1948 by S S Apte, who also established the Vishva Hindu Parishad.

Now trending: Board-managed companies

The board will take on a more complex role and its skill set will see an overhaul. Regulators, investors should prepare a framework to deal with this shift

THE OCCASIONAL ASIDE

AMIT TANDON

Institutional ownership of the S&P BSE 500 companies has been steadily increasing. But there is another discernible shift within, regarding governance of companies, that is taking place: The number of companies that are both institutionally owned and board-managed is starting to increase rapidly. This will have far-reaching consequences for the market.

Data on institutional ownership (foreign institutional investors, domestic institutional investors and other institutions), widely tracked, show institutional ownership at 37.9 per cent in March 2017, up from 31 per cent in March 2001 and a low of 29.2 per cent in December 2008. The second set of companies — board-managed companies (BMCs) have also seen an increase. Expect companies in this set to see the rapidest growth for a number of reasons, discussed below.

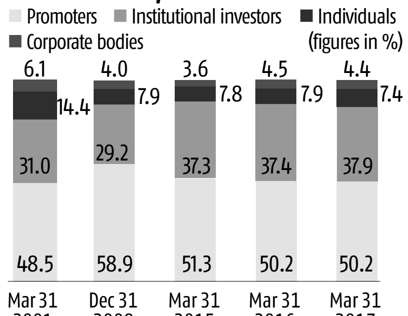
First, expect more of the existing board-managed companies to list their existing subsidiaries. ICICI Bank has listed its life insurance subsidiary and is working to list its general insurance arm. Larsen & Toubro listed two of its subsidiaries. Though promoted by ICICI and L&T, these better fit the board-managed category. For those not convinced, I will go back a few decades: HDFC, promoted by ICICI, snapped its umbilical cord as they treaded on each other. The pace of change is faster now.

Two, market infrastructure companies like stock exchanges and depository companies are beginning to get listed.

Three, spin-offs such as Crompton Greaves carving out their consumer business and selling it to private equity (PE). Expect PE to steadily add to this number as they back professional teams — the number of buyout funds and transactions today is a clear pointer. When the scale of operations was small, they exited to other larger PE firms. But as PEs have put more and more capital to work, it's markets that provide the most viable exit. And though they may "control" the business today, expect them to exit completely tomorrow, leaving these businesses to be run by boards. Finally, while regulators still frown on promoter-less listings, they are no longer black swan sightings. There is a steady stream of such offerings in the market. Collectively, these will matter, particularly as they become part of the frontline indices — which they will.

What should one expect when professionally-managed companies gain ground? As more and more businesses are board-managed, boards will move centre stage, with the roles becoming more complex. The buck will stop at the board: Look no further than Infosys' board. There are no "promoters" to turn to for strategic decisions or to recapitalise if needed. The skill levels expected by the board are of a higher order as they achieve a

NSE500 OWNERSHIP BY CATEGORY, 2011-17



Sources: ACE, IiAS

NSE500 OWNERSHIP BY MANAGEMENT, 2011-17

Category	2011	2015	2016	2017	% rise
Board-managed	21	23	24	31	147.6
MNCs	46	61	62	59	128.3
Promoter-owned	372	347	347	344	92.5
PSUs	61	69	67	66	108.2
	500	**500**	**500**	**500**	

Sources: Market, IiAS

balance between the appropriate amount of oversight and guidance. They will need to be familiar with the company's business, but will also have to bring some additional skills to the boardroom. While all this no doubt is true today, for the majority of companies, there is a promoter — whether a business family, a foreign parent or the government of India — so boards are not being stretched. In the future, though, the skills needed are set for a dramatic overhaul.

At present the fuss is all about related party transactions. Are these abusive? Are these being using to tunnel money? Regulations are focused on protecting minority investors. Markets and regulations will need to evolve from defining board composition, with reference to promoter and non-promoters, to skill sets on the board and from liabilities of the promoters to dealing with boards that glad-hand CEOs.

This focus will also shift to compensation. We already see many "promoters" disregarding performance-linked pay when voting for their own pay rise. Their membership of the remuneration committee makes this easy. In professionally managed firms, we are already seeing senior management cornering a large portion of employee stock ownership plans (Esop) for themselves, and then doubling up on these by grabbing them from subsidiaries. As boards come to rely more on CEOs to deliver, and CEOs drive decisions on board rewards, the risk of an unhealthy bond between them will only increase. Compensation is difficult to regulate. So, institutional investors will need to evolve their approach. We are seeing some global investors routinely shoot down compensation if it is higher than the median pay rise. This will need to be more widespread if it needs to be effective.

Admitted, this change will not happen overnight, but the market does not have the luxury of taking a generational view either. It is therefore important that both regulators and investors develop a framework to deal with the coming shift. And the best time to begin is now.

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BUSINESS LIFE

Blind 'drivers' step up to shape push for driverless cars

Advocates say autonomous carmakers need to rethink car design

RYAN BEENE

Policymakers and companies working on self-driving vehicles are just beginning to deal with roadblocks for blind drivers PHOTO: ISTOCK

Anil Lewis was behind the wheel of his Ford Mustang convertible on a sunny Atlanta day in 1988, when he nearly hit a pedestrian who appeared in a crosswalk ahead of him, seemingly out of nowhere.

It was then Lewis realised his deteriorating eyesight would soon end his days behind the wheel. Now 53 and legally blind, the prospect of fully autonomous vehicles gives him hope of returning to the road on his own.

"If it's designed correctly, if the vehicles are accessible, it's going to create an improved ability to travel that doesn't currently exist," said Lewis, executive director of the National Federation of the Blind's Jernigan Institute, which works to develop technologies and services that help the blind.

The revolution in self-driving cars holds promise for a segment of the population that thought they'd never be able to operate a vehicle — the blind. Advocates for the estimated 1.3 million legally blind people in the US, and millions more with other disabilities, have joined automakers and technology companies in lobbying Congress to help spur the roll out of self-driving vehicles.

A House panel on Wednesday will consider its first legislation on driverless cars, and advocates for the blind have a special set of concerns: They want accessibility incorporated into car design and states to steer clear of laws that would prohibit the blind from one day sitting in the driver's seat.

They're up against a regulatory and industry paradigm that assumes drivers see the road ahead. Policymakers and companies working on fully self-driving vehicles — still many years away from being widely available — are only beginning to tackle new challenges to ensure that the blind can benefit, and some roadblocks are already emerging.

Alex Epstein, senior director of digital strategy at the National Safety Council, says autonomous vehicle technology still has a long way to go until vehicles don't have a steering wheel or brake, and the driver can be removed from the equation.

"In theory, the concept is a wonderful idea," Epstein said. "The question is how does the auto industry and the tech industry get to that place."

The National Federation of the Blind has begun airing radio ads as part of a new coalition of representing the hearing-impaired, the elderly, carmakers and Securing America's Future Energy, an energy-independence advocate. It's also joined the Self-Driving Coalition for Safer Streets, an advocacy group that represents Ford Motor Co, Volvo Cars AB, Alphabet Inc's Waymo unit, Uber Technologies Inc and Lyft Inc.

The auto and tech industry's vision of robotaxi fleets could improve access to employment and education that have long been among the blind federation's top policy priorities, said spokesman Chris Danielsen. The group is concerned about state policies that could limit the blind's access to autonomous rides in the future.

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LETTERS

Celebrity employees

Celebrities from various fields are nominated to Parliament. Sportspersons are recruited to various positions in the government, statutory bodies, public sector undertakings and sometimes companies. Beyond recognising individual contribution to public life or sports, there is no evidence to show that such assignments benefit Parliament where they get represented or organisations that recruit them.

At some stage, the media or the human resource departments of organisations publish analyses of the attendance or contribution of these "nominees". Clearly, there is a gap between expectations from these members of Parliament and employees who, from the viewpoint of their colleagues, get "out-of-turn" entry into positions occupied by people, who come through usual channels of election/recruitment. The philosophy of recognising eminence or promoting sports in the national interest does not help counter the arithmetic about "contribution and attendance".

Being more transparent about selection and assignment of roles relevant to the positions assigned might minimise criticism from various quarters. It is common knowledge that celebrities and sportspersons would not be present in the House/office every day, as their priorities lie with their professions. But to serve the purpose of being part of Parliament/organisations, at the time of induction they should be given orientation making them "ambassadors" of the causes that the nation/employers stand for. Such induction programmes should be followed up with periodical refresher seminars, which should be addressed by experts and trainers of repute.

M G Warrier Mumbai

Mockery of the system

With reference to the report, "'VIP treatment' for imprisoned Sasikala: DMK demands probe" (July 18), criminals are sent to prison by courts of law, as punishment for proven crimes. The purpose is twofold — to prevent them from committing another such offence, at least during the term of imprisonment, and to provide them sufficient time to reflect and reform.

However, in India, one is dismayed to hear about the five-star comforts enjoyed by some high-profile VIP criminals in jails. So much so that these inmates are able to continue their criminal activities with impunity, as they have unrestricted access to mobile phones, not to speak of other modes of communication.

This makes a mockery of our criminal justice system and the huge cost borne by taxpayers for the upkeep of jails.

V Jayaraman Chennai

Pluralism is key

The Karnataka government's decision to set up a panel "to design a separate state flag" has kicked up a row. Seeing it as a direct challenge to "India's unity and integrity", right-wing hyper-nationalists are trying to stop it. This, even though neither the Constitution nor any law expressly or obliquely prohibits a separate flag for a state. In fact, the Bommai judgment allows a state to have its own flag if it wills it. It is wrong that a separate flag should be linked to separatism or secessionism.

A high degree of autonomy or decentralisation of power is essential for the practice of "cooperative federalism"; it is not prejudicial or detrimental to Indian nationhood. The rise of "cultural nationalism", a euphemism for chauvinist Hindutva, and the blatant imposition of Hindi undermining the importance of Kannada seem to have precipitated Kannadigas into favouring a flag of their own.

The Hindi belt does not make up India; the notion that one must be a Hindi-speaking upper caste Hindu to qualify as a complete Indian is unacceptable. The Bharatiya Janata Party must ponder whether it is a party big enough to accommodate all Indians irrespective of their disparate identities. Upholding our composite culture and giving all Indians a sense of their worth hold the key to national unity.

G David Milton Maruthancode

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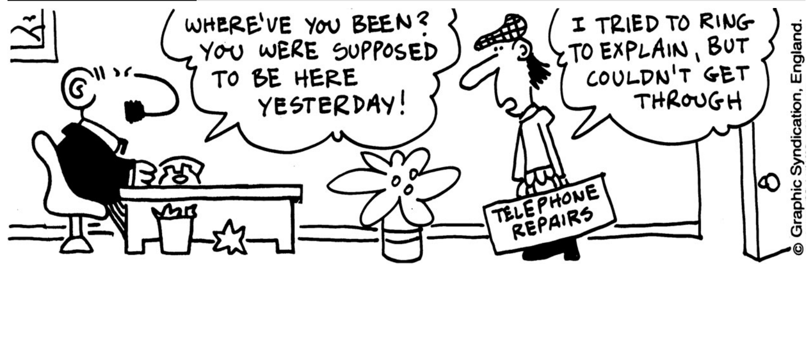
HAMBONE

BY MIKE FLANAGAN



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Ballooning state debt

Populism and profligacy undercut India's fiscal stability

The newly elected government of Uttar Pradesh presented its first Budget last week. There was considerable interest in the run-up to the Budget presentation, given that the Bharatiya Janata Party had promised on the campaign trail to waive off large amounts of agricultural debt and that Union Finance Minister Arun Jaitley had specifically said that the central government would not pay for the loan waiver. The loan waiver might cost as much as ₹36,000 crore. Since Uttar Pradesh was already deeply indebted — with a state debt-to-state gross domestic product ratio of around 30 per cent — the question was how would this fresh call on the exchequer be managed? The answer is now available, and it does not inspire confidence. It turns out that the extra spending will be managed through two changes from the interim Budget presented earlier. First, the government has reduced its power allocation by ₹16,800 crore. And second, total revenue is projected to increase by 18.6 per cent over the previous year, as opposed to an 11.4 per cent increase in the interim Budget. It turns out that much of this increase will, in fact, be through grants from the Centre, regardless of Mr Jaitley's assurances. According to the Uttar Pradesh Budget, grants from the Centre will grow by an unusually large 39 per cent to ₹68,000 crore. If for some reason that largesse from the central government does not materialise, then the state's fiscal deficit will only rise.

Uttar Pradesh's problems are not unique. Other states that have promised farm loan waivers, Punjab and Maharashtra among them, will have similar problems in raising revenue while meeting their fiscal targets. Meanwhile, pressure is growing on other states across the country to meet demands from farmers under stress after two consecutive droughts followed by demonetisation. Already state-level finances were showing signs of serious strain, starting in financial year 2015-16. For the first time in a decade, the ratio of gross state fiscal deficits to the gross domestic product (GDP) crossed the 3 per cent threshold to hit 3.6 per cent. The problem continued into 2016-17, according to the Reserve Bank of India's report on state finances. The RBI report also warned that, aside from loan waivers, state finances would suffer from the implementation of Pay Commission recommendations and from the revenue uncertainty associated with the implementation of the goods and services tax.

The markets are already responding to this unsustainable spending path. Spreads on state debt over sovereign paper of equivalent maturity have widened to between 74 and 83 basis points, up from around 50 basis points last October. The problem is not just that India's overall fiscal position, judged by the ratio of general government debt to GDP, will suffer through states' profligacy and populism. It is also that the money being spent will be diverted from important alternative uses. Capital expenditure might suffer, particularly expenditure targeted towards the agricultural sector, which has faced chronic underinvestment for years. Fears over ballooning state deficits have been expressed for some months now, but the Uttar Pradesh Budget suggests that these have been, if anything, understated.

Make it palatable

Import duty structure for edible oil needs correction

There is increasing evidence to suggest that both oilseed growers and the oilseed-based industry are struggling to survive. They are unable to compete with imported vegetable oil, which is cheaper, thanks to flawed policies and irrational import duties. About a fifth of the last season's bumper soybean harvest is likely to remain uncrushed. Growers are unwilling to part with the stock at unremunerative prices, which have dipped by 20 to 30 per cent since June last year and are below the government-guaranteed support level. Initial trends of oilseed sowing in the current kharif season indicate that the area under these crops will shrink sharply. This will exacerbate India's dependence on imports, which already stand at 70 per cent. The ground reality is in stark contrast to Agriculture Minister Radha Mohan Singh's recent assertion that the government wants to make the country self-reliant in edible oil.

The root cause of the current dismal state of affairs is the ill-advised import tariff structure, which fails to guard the interests of oilseed producers and processors. The current import duties on edible oil, besides being too low considering the slump in the international vegetable oil market, tend to make the import of refined oil more attractive than crude or unprocessed oil. This inverted structure ends up supporting the refining industry in exporting countries at the cost of the domestic processing sector. As such, the Indian industry's pleas to raise the import duties and correct the tariff inversion between crude and refined edible oil merit consideration. The present low food inflation makes it an opportune time to do so without hurting consumers.

Achieving self-reliance in edible oil is, indeed, not all that difficult. In the 1980s, a demand-supply gap of over 45 per cent was successfully bridged in a short span of just a few years. This feat — hailed then as the yellow revolution — became possible with the setting up of the Oilseeds Technology Mission in 1986 with full freedom to frame and enforce policies concerning production, pricing and import of vegetable oil. The strategy adopted and, more importantly, efficiently implemented by the mission focused on managing oilseed prices to incentivise local production and regulating imports in line with the domestic situation. Under this strategy, local oilseed and edible oil prices were allowed to fluctuate within a stipulated band that secured the interests of both producers, who needed remunerative returns, and consumers, who wanted cooking media at reasonable rates.

Government interventions in the market, including well-judged changes in import tariffs, were undertaken when prices tended to breach the set limits. However, this sensible mechanism to sustain a steady growth in oilseed output and, at the same time, hold the price line was abandoned in the mid-1990s, frittering away its gains. Pricing policies since then have tilted in favour of consumers without balancing the interests of the other stakeholders, farmers and the industry. There seems little reason why the Oilseeds Technology Mission's formula cannot be resurrected to bail out the edible oil sector and cut down on the unwarranted and heavy dependence on imports.

ILLUSTRATION BY BINAY SINHA

Widening of direct tax base

Notwithstanding demonetisation and GST, the jury is still out on the government's ability to achieve this goal

Implementation of the goods and services tax (GST) from July 1, 2017, is a huge step forward in uniform nation-wide collection of indirect taxes. Prime Minister (PM) Narendra Modi mentioned in his speech in Parliament on July 1 that GST would promote a "corruption free (indirect) taxation system". Any number of experts have commented on the enhanced transparency of GST nudging India towards one market despite the implementation difficulties and disadvantages of multiple GST rates.

JAIMINI BHAGWATI

Comparatively little has been said about evasion of direct taxes based on the familiar yet startling information included in PM Modi's speech at the Chartered Accountants' Day again on July 1, 2017. This is perhaps because the facts sit uncomfortably with our wealthy kleptocrats and revenue-administrative service officials. For instance, the PM said that India has: (a) 800,000 doctors; (b) more than 20 million engineers; (c) about 800,000 accountants; and (d) 21.8 million Indians went on holidays to foreign destinations last year. However, just 3.2 million taxpayers declared an annual income above ₹10 lakh. This 3.2 million taxpayer number is ridiculously low, particularly as the PM has highlighted many of those included are salaried employees in government or the private sector.

On July 12, a few members of the Parliamentary Standing Committee on Finance were critical of the Reserve Bank of India (RBI) for not yet having counted the cash which was deposited post demonetisation. The suspicion is that RBI is not providing this information since all the currency which was held by the public has come back to it through banks. The sceptical conclusion is that demonetisation was a failure in unearthing unaccounted cash.

In his Budget speech on February 1, 2017, Finance Minister (FM) Arun Jaitley stated that post demonetisation cash deposits, ranging from ₹2 lakh to ₹80 lakh, were made in 11 million bank accounts. In another 148,000 accounts, the deposits were above ₹80 lakh each and the average deposit size was ₹3.3 crore. These figures again underscore that this number of just 3.2 million taxpayers with annual income above ₹10 lakh is absurdly small.

In the context of demonetisation, the PM said at the Chartered Accountants' Day event that the "government has placed a massive system for data mining, for the money stocked with banks, whereby the details of the transactions of money before and after November 8 (2016) have been extensively studied". And, "whatever data mining has been done till now has revealed that the transactions of more than 300,000 companies are under the radar of suspicion". The PM asked "don't you (chartered accountants i.e. CAs) feel the need to identify such people, who are sitting among you, who supported these companies (in laundering black money via shell companies)?" PM Modi mentioned that "over 1,400 cases (against CAs) are pending for several years (and asked) isn't this a source of worry for such highly qualified professionals?" As government identifies income-tax evaders and complicit CAs it should be extremely watchful to prevent revenue officials from going on fishing expeditions to harass and extort.

The pointed reminder from the PM to CAs to desist from helping those trying to whitewash their black money is useful. However, it is unlikely that this exhortation would be sufficient. Even some large well-known Indian companies deliberately fudge their income statement numbers to minimise tax dues and this cannot happen without the collusion of accountants. On a provocative note, if an industry body such as the Institute of Chartered Accountants of India can function as an effective regulator of CAs, why should the Association of Mutual Funds of India not regulate mutual funds rather than the Securities and Exchange Board of India? It is high time that a statute-based regulator is set up for CAs.

In recent months there are anecdotal reports that significant proportions of real estate purchases are again being transacted in cash in high-value notes. To an extent, this has become easier because the highest value note has doubled from ₹1,000 to ₹2,000. Studies in Europe and the US have shown that high-denomination notes do not enhance economic activity and are often used to evade taxes. If government is serious about clamping down on tax evasion, it needs to work with RBI to gradually but consistently eliminate high-value notes over the next couple of years. This sounds drastic but the poor do not hoard large volumes of high-denomination notes. A pre-requirement is unfailing internet connectivity even in the remotest rural areas to enable cash-less transactions.

On a less hopeful note, the FM introduced the concept of anonymous electoral bonds in his Budget speech on February 1. Such bonds would be issued by banks after donors to political parties deposit the corresponding amounts in banks. These bonds would then be credited to accounts of political parties which are registered with the Election Commission of India (ECI) and there would be no cap on such donations as was the case earlier. The government's stand is that these electoral bonds will ensure that only legitimate and post-tax paid funds would be donated to political parties. However, Section 182(3) of the Companies Act has been diluted to exempt companies from having to name the specific political parties to whom donations have been made.

On June 1, 2017, it was reported that the ECI has formally written to the law ministry asking the government to "reconsider" and modify the recent amendments, relating to electoral bonds, of the Representation of the People Act and the Companies Act. The ECI has suggested a reversion to the status-quo ante. In a written response to the Parliamentary Standing Committee on Personnel, Public Grievances and Law & Justice, the ECI has correctly stated that electoral bonds amount to a "retrograde" step since introduction of such bonds "compromises transparency".

To sum up, the jury is still out on the ability of the government to widen the base for direct taxes. The government needs to use the information it has collated post demonetisation fairly and systematically plus reverse the steps which allow anonymous electoral bonds.

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Has note ban made money more efficient?

It is now nearly eight months since November 2016. As on July 7, 2017, the newly printed currency in circulation (CIC) reached 84 per cent of the extinguished one (CIC at 86 per cent of pre-demonetised levels). In addition, cash on hand with banks, a CIC component has now declined to 5.4 per cent of the former (from the peak level of 23.2 per cent in November 2016).

SOUMYA KANTI GHOSH

Even as the economy is now close to complete remonetisation, two issues continue to hog the limelight: (1) Whether ATMs are now churning out currency according to the customer needs and (2) the tangible benefits from this humongous exercise. We take up these issues one by one. Before we address such issues, let us make some reasonable estimates of currency printed by the Reserve Bank of India (RBI) of different denominations till date. Given that RBI has refrained from publishing the currency notes printed after December 19, 2016, any estimate of currency notes will be based on certain assumptions.

RBI publishes the number of currency notes printed of different denominations in its annual report. In March 2016, there were 16 billion and 6 billion pieces of ₹500 and ₹1,000 notes, respectively, aggregating 48 per cent and 38 per cent of the total currency value. There were also 16 billion pieces of ₹100 notes, contributing 10 per cent of the total value. The remaining 4 per cent of the currency value were contributed by notes up to ₹50, which aggregated to 53 billion.

Now fast forward to current printing status. According to RBI's annual report, it placed indent for 24.6 billion pieces for FY17. Assuming that printing presses supplied the requisitioned as well as extra amount which was printed to meet the demand arising out of demonetisation, possibly an incremental 37 billion pieces of currency notes of small denomination, constituting 28 per cent of the total value (14 per cent earlier), are now in circulation. Even if we assume that the remaining amount is divided equally between ₹500 and ₹2,000 denominations or 72 per cent in value terms (12-13 billion pieces of ₹500 and 2 billion pieces of ₹2,000), this means an incremental ₹2.5 lakh crore of notes in value terms are still to be printed (3-4 billion pieces of ₹500 notes may not have been printed) if we replenish the entire demonetised stock. Herein lies the importance of new ₹200 notes.

Going by the above data, it thus seems that there has been a significant move towards relocating distribution of currency towards smaller denominations post demonetisation. However, while such a move is laudable and consistent with the long-term vision of a less cash economy, we also need to consider the following. Though the number of small-denomination notes has increased, the mismatch caused by the presence of ₹2,000 denomination straight after ₹500 denomination is causing difficulties in exchanging the high-denomination notes. Interestingly, this may also be resulting in people holding back smaller denomination notes like ₹100.

Whatever be the reason, an ATM machine typically holds 10,000 bills and if these were to comprise say only notes of ₹100, the number and cost of replenishment goes up significantly. Herein lies the paradox. Notes of ₹2,000 denomination in ATMs may find few takers because of missing middle —₹200.

How is this reflected in currency data? Historical trends suggest that cash on hand with banks is roughly 3.8 per cent of CIC and is currently at 5.4 per cent. This means at least an additional amount of 1.6 per cent or ₹25,000 crore of excess currency may be currently lying in ATMs because of reasons as pointed out above.

How does all these add up for our answer to question number 1 as posited earlier? Yes, the ATMs are now churning out currency notes of smaller denomination like ₹100. However, these notes have to be replenished quickly given ATMs' holding capacities. In this context, ₹200 notes can be a missing middle between ₹500 and ₹2,000.

Let us now come to the second question. One of the most perceived benefits of demonetisation is declining velocity of money (defined as GDP/currency with public) as we progressively move towards digitisation. It is an irony that income velocity of money that was at 8.8 in FY1960, was mostly in double digits till FY2000, after which it has been consistently in high single digits.

If we try to juxtapose it with the monthly income velocity, velocity on an average during H1FY17, it more than doubled after demonetisation (Q3FY17). However, velocity since Q3 has been declining. This in turn implies that situation is improving with sufficient amount of cash available for transaction in the system, though the velocity is still higher than pre-demonetisation levels.

Interestingly, the significant increase in income velocity during demonetisation defies a conventional explanation in economic terms. In economic parlance, velocity of money is stable and is primarily determined by the level of economic activity among others. The only way velocity of money could have jumped in Q3FY17 was possibly that economic activity in the informal sector was supported largely by credit, given that cash was not forthcoming. If this is true, this may also explain why Central Statistics Office's (CSO) gross domestic product numbers for Q3 defied all odds to fetch up a growth in excess of 7 per cent! The surge in consumption in the CSO estimates during this quarter also becomes easier to substantiate with these unorthodox explanations.

To sum up, if velocity of money continues to decline, it would mean money is indeed becoming more efficient post demonetisation amidst increased digitisation! It can, however, also be argued that close to ₹3 lakh crore of CIC in the banking system is still idle and this may be driving the velocity down. But the good thing is that there has also been a cultural transformation in the psyche of customers who are now doing more than 40 per cent more transactions at PoS (point of sale) machines compared to pre-demonetisation levels! This means that a large part of such idle cash could be a permanent money creation in the banking system, driving down the cost of credit in natural progression!

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The unlikely demise of capitalism

BOOK REVIEW

ISHAN BAKSHI

Naysayers such as Karl Marx and Friedrich Engels weren't the only ones who wrote obituaries of capitalism. Other esteemed economists such as David Ricardo, John Maynard Keynes and Joseph Schumpeter prophesied the systems demise. Some even expected it to collapse during their lifetime.

Yet somehow capitalism's long foretold demise never materialised.

And while it is true that capitalism has lurched from one crisis to another, it has survived by often transforming its economic and social institutions. This is what its naysayers have failed to account for time and again. A careful examination of the system's evolution over the past two centuries reveals its remarkable ability to adapt to the changing milieu.

Wolfgang Streeck, an eminent sociologist, lays out its trajectory over the past few centuries in his new book *How Will Capitalism End?*

In the 19th century, liberal capitalism suppressed a revolutionary labour movement with a combination of repression and co-option, which included democratic power-sharing and social reform. But in the early 20th century, capitalism was commandeered to serve national interests in international wars.

Subsequently, in the aftermath of the Great Depression, this liberal strand of capitalism was replaced by Keynesian, state-administered capitalism. And out of this grew democratic welfare state capitalism. Although this evolution is testament to the system's ability to adapt, Mr Streeck argues that "next time whatever cavalry capitalism may require for its rescue may fail to show up".

But is this time really that different? Several others have also predicted the demise of capitalism recently.

Immanuel Wallerstein, for example, has argued that a battle is shaping up between defenders and opponents of the capitalist order.

Craig Calhoun believes that it is possible for the current system to be replaced by a centralised socialist economy with characteristics of Chinese-style state capitalism.

Mr Streeck has used these theories as his building blocks. But where he differs from others is what comes after.

Rather than prophesise the contours of the replacement, he contends that it is not necessary for an alternate system to emerge to replace capitalism.

"What comes after capitalism in its final crisis now underway is... not socialism or some other defined social order but a lasting interregnum – no new world system... but a prolonged period of social entropy or disorder."

This, he argues, is conditional on interrelated developments such as falling growth, which heightens distributional conflict, ineffectiveness of macroeconomic policies, rising indebtedness, dwindling state capacity, the suspension of democracy, post-war capitalism's engine of social progress, and the associated rise of oligarchic rule.

Mr Streeck identifies three mutually reinforcing trends that are exacerbating the system's decline — declining growth, rising inequality and rising debt.

It's easy to see the vicious cycle. Low growth aggravates inequality which in turn restricts demand, thereby lowering growth further. "High levels of existing debt clog credit markets and raise prospect of financial crisis. Also an overgrown financial sector both results from and adds to economic inequality."

While these forces have operated in the past, they appear to be more acute this time around.

"Nothing is in sight that seems only nearly powerful enough to break the three trends, deeply engrained and densely intertwined as they have become," he says.

Some argue that Mr Streeck underestimates the system's resourcefulness. But to be fair it's difficult to prophesise how things will pan out.

It is plausible that artificial intelligence may well attack the jobs of the middle class, just as manual jobs have been destroyed in the past. And if this happens, then the middle class, the defenders of the current system, may also revolt against it. Already, we are seeing waves of resentment leading to populist victories in the West. But as the history of capitalism has shown, labour has always been accommodated.

On the rise in inequality, it is plausible that individuals might accept higher levels of inequality if there is a sustained increase in income levels. But will absolute income gains coupled with some sort of universal basic income temper the outrage over higher inequality? It's difficult to say.

And what about China and India?

The two have been the biggest gainers of the system over the past decades and now have a greater stake in ensuring continuity even as they continue to shape it. It is ironical to see the Chinese President Xi Jinping championing free trade at Davos at a time when the US is looking inwards.

Further, the decline of the current western form of capitalism may not necessarily mean the decline of all forms of capitalism. Other forms, such as China's state-driven capitalism, posit alternative models.

But can it emerge as the dominant system?

Mr Streeck is sceptical. "Western capitalism will decay but non-western capitalism will not take its place, certainly not on a global scale and neither will western non-capitalism," he writes, adding that "China will for many reasons not be able to take over as capitalism's historic host. Nor will there be a co-directorate of China and US."

HOW WILL CAPITALISM END?
Essays on a failing system
Wolfgang Streeck
Juggernaut
262 pages; ₹499